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IN THE

# Supreme Court of the United States

October Term, 1956

No. 316.

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,

*Petitioner,*

*vs.*

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC. and WARNER BROS. PICTURES, INC.,

*Respondents.*

**On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.**

## BRIEF FOR PETITIONER.

### Opinions Below.

The opinion of the District Court rendered December 16, 1953 is reported in 117 Fed. Supp. 781. The opinion of the Court of Appeals [R. 665-673] filed May 21, 1956 is reported in 237 F. 2d 317.

### Jurisdiction.

The judgment of the Court of Appeals was entered on May 21, 1956. The petition for certiorari was filed with the clerk of this Court on August 13, 1956. The jurisdiction of this Court is invoked under Act of June 25, 1948, c. 646, 62 Stat. 928, 28 U. S. C., Section 1254(1).

**Constitutional Provisions, Statute, and Rule Involved.**

Article III, Section 1, Constitution of the United States, provides, in part: "The judicial power of the United States, shall be vested in one supreme court, and in such inferior courts as the Congress may from time to time ordain and establish."

Article III, Section 2, Constitution of the United States, provides, in part: "The judicial power shall extend to * * * controversies * * * between citizens of different States * * *."

Act of June 25, 1948, c. 646, 62 Stat. 930, Title 28, Section 1332(a) (1), United States Code, provides, in part: "(a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $3,000 exclusive of interest and costs, and is between: (1) Citizens of different States * * *."

Rule 23(b) of the Federal Rules of Civil Procedure provides:

> "(b) Secondary Action by Shareholders. In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the

plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort."

## Questions Presented.

Jurisdiction based on diversity of citizenship is present in the first count of this stockholder's derivative suit, only if the corporation was properly aligned as a *defendant*. If—as the courts below have decided—the corporation must be realigned as a complainant because the stockholder failed to prove that the corporation was "dominated and controlled" by the codefendants, then diversity of citizenship is lacking. The questions presented are:

1. Where the directorate of a corporation which is *not* dominated or controlled by its president or vice-president is, nevertheless, admittedly opposed to a stockholder's claim asserted in a derivative suit in a federal court viz: his corporation is dealing unfairly with a corporation which is owned by the president's son-in-law and causing him to become unjustly enriched at the expense of the stockholder's corporation; where these directors are avowedly hostile to the suit and its objects; where the stockholder's corporation appears in the action, unites with its president and vice-president in resisting the stockholder's claim of illegality; unites with them in opposing his prayer that the Court terminate the dealings and cancel the contract between the two companies and prays the complaint be dismissed; where counsel for the stockholder's corporation admits in open Court "no matter what demand the plaintiff

stockholder had made on the directors, they would never have brought this suit"; is not the stockholder's corporation rightly aligned as a defendant in such a suit?

2. Was it not error to destroy diversity of citizenship and consequently jurisdiction over this controversy by realigning the stockholder's corporation as a complainant and then to dismiss for failure of jurisdiction?

**Statement.**

Edward S. Birn, a New York citizen and stockholder of Warner Brothers Pictures, a Delaware corporation, invoked the diversity jurisdiction of the United States District Court for the Southern District of California in two causes of action of a derivative suit.

Named as defendants in the first cause were the corporation (Warner corporation or "Warner" for short), its president and vice-president, Harry Warner and Jack Warner, both citizens of California; the president's son-in-law, Milton Sperling, a California citizen; and United States Pictures ("United" for short), a Delaware corporation owned by Sperling and his two children. [R. 378-380.]

Named as defendants in the second cause were the Warner corporation and Harry and Jack Warner. Sperling and United were not named in this second cause. [R. 11:]

The gist of the claim: Dealings between Warner and United in a motion picture joint venture, terms of which were negotiated by president Harry Warner with his son-in-law Sperling [R. 116, 129, 136, 169] and incorporated

into a Warner-United contract and a series of amendments thereto, are unlawful and are enriching Sperling unjustly at Warner's expense. [R. 5, 8-10.] Complainant prayed the Court to halt the dealings between the two companies, terminate their relationship, cancel their contract [R. 15], and for other relief.

Warner appeared in the suit and combined with the co-defendants in resisting complainant's claim and prayer: In a joint answer with the brothers Harry and Jack Warner who were charged with a breach of trust in connection with Warner-United dealings, Warner denied complainant was a citizen of New York [R. 20]; denied the truth of his claim [R. 20-24]; pleaded the bar of the Statutes of Limitations of three states [R. 24-25], and prayed the complaint be dismissed. [R. 26.] United and Sperling entered a similar plea. [R. 16-20.]

The merits of the controversy, *i.e.*, whether the Warner-United dealings are in fact unlawful and should be terminated and whether the Warner-United contracts should be ordered canceled to the extent that they remain unexecuted, *were not reached.* [R. 583.] The Court ordered that two issues,

(1) Jurisdiction, and

(2) The bar of the Statutes of Limitations,

be inquired into preliminarily [R. 72, 572, 586] before it would consider the merits. [R. 583.] The parties were directed to appear and present evidence *"only as to those issues."* [Findings, R. 72.] "Thereupon, evidence on behalf of plaintiff and defendants was offered and received, *the cause argued and submitted upon the two above stated issues only."* [R. 72; emphasis added.]

The inquiry into jurisdiction unfolded the following realities: Complainant Birn was a citizen of New York. The defendants are all citizens of states other than New York. [R. 73.]

Warner is owned by the public; its stock is listed and traded on the New York Stock Exchange. [R. 119.] Some 30,000 persons located all over the world are its shareholders. [R. 120.]

Three of the stockholders, namely the brothers, Harry, Jack and Albert Warner, have a working control of the company: They own between 15 and 20 per cent of its outstanding stock. [R. 75, 120.] They are the company's managers [R. 112]; they "run" the company [R. 259-260]; they control its over-all—its basic policies [R. 492]; they control the naming of Board members [R. 195, 283-284, 291, 305-306] and the re-election of directors at the expiration of their terms; and the employment of these men by the company in various capacities at substantial salaries and retainers. [R. 195-196, 490, 600.]

The likelihood of sitting on the Warner Board unless one stays acceptable to the brothers Warner is virtually nil: Three directors (out of eight who, along with the brothers compose the Board) *admit,* in substance, that to become *persona non grata* to the brothers would mark the end of their relationship with the company. [R. 490, 304-305, 291-292.]

Each of the three gentlemen, namely, Mr. Friedman, Mr. Perkins and Mr. Wolf, derives a substantial income from the company. [R. 600.]

The composition of the Warner Board is controlled by Harry Warner. Director Carlisle says, in so many words,

that Harry Warner controls the naming of Board members and that Harry and his two brothers control whether or not Carlisle [he draws a substantial salary as Comptroller, R. 600], stays on in the company's employ. [R. 195-196.]

Two other directors, namely Guggenheimer and Catchings, admit in substance, that their presence on the Board is virtually at the brothers' pleasure. [R. 283-285, 264.] Mr. Guggenheimer is the senior member of a law firm under retainer to Warner. [R. 271, 600.]

Proxy machinery—set in motion annually—serves to perpetuate an environment in which the brothers Warner exercise this admitted mastery and sway: A month or so before stockholders' annual meetings, which are held in Delaware, the gentlemen on the Board nominate themselves and then stand for re-election [R. 260-261]; paid agents —paid by the company—are employed to campaign for them by mail and telephone. Stockholders are solicited to appoint as their proxies a "proxy committee" the membership of which is admittedly candidate-chosen; the proxies garnered then serve to rubber-stamp, so to speak, the candidates' choice of themselves as their successors. [R. 597-599.] The expense of "—preparing, handling, and mailing the proxy statement and the proxy and the charges of brokerage houses and other custodians—" are paid by the company. [R. 598.]

Each of the six gentlemen aforenamed were seated on the Warner Board, without interruption, during many years preceding and following the institution of the suit. [R. 27.]

Warner produces motion pictures in vast studios which it maintains in California. Subsidiary companies distribute its product throughout the world. [R. 117, 118-119.] Harry Warner is Warner's Chief Executive. [R. 119.] Sperling is his son-in-law.

Ever since September 28, 1945, the two corporations Warner and United, have been engaged in a joint venture in motion picture production—distribution: On that day, Albert Warner informed a quorum composed of himself and the six aforenamed Warner directors [R. 605] that the brothers Warner favored the corporation's entering into an arrangement with United [R. 191, 193-194, 493], a newly formed company owned by Sperling and Joseph Bernhard[1] whereby Warner shares with United the costs and profits of six feature pictures, to be produced two each year during the ensuing three-year period. All seven gentlemen who comprised the quorum recorded their ap-

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[1]Bernhard was a Warner director, employed by the company as a "managing executive" for which he was paid $3,000 a week. [R. 603-604.] He managed Warner theatres. He had no experience in making pictures [R. 126-327], but he had good connections with the New York Trust Company. [R. 123.] John Bierworth, president of that bank, was his friend. [R. 122.]

A few months before, Harry Warner had suggested to Bernhard that Harry and brother Jack would approve of Warner's entering into a profit-sharing venture with a company owned by Bernhard and Sperling in equal shares, if Bernhard could get the New York Trust Company to loan such a Bernhard-Sperling company half of the production cost of a series of pictures. [R. 124-125.]

Bernhard obtained the commitment from Bierworth [R. 128]; gave up his $156,000 a year job with Warner [R. 602-603]; United was formed; Sperling acquired one-half of its stock for $12,500 and Bernhard the other half for a like sum. [R. 130.] Less than a year later Bernhard sold his stock interest in United to Sperling for $400,000 cash—a profit of $387,500. [R. 135, 163-164.]

proval.[2] The arrangement was embodied in a written contract. [R. 607-651.] Negotiators of its terms were Harry Warner and Jack Warner with Sperling and Bernhard. [R. 116, 129, 161.] Stockholders' approval thereof was neither sought[3] nor obtained. [R. 31.]

On December 6, 1947, a few months before the three-year venture period provided by the Warner-United contract was due to expire (and only three of the six pictures had been produced), Harry and Jack Warner, acting for Warner, and Sperling for United [R. 136] negotiated an amendment [Ex. 4; R. 651-656] whereby the life of the venture was extended to and including the year

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[2]None of the seven men who composed the quorum faced the Court, except Friedman. Their depositions, taken in New York at the instance of the defendants, were read. Each was asked the question, namely, had anyone told him how he should vote on the matter, and each replied in the negative. [R. 177, 249, 275, 287, 297, 457.] Four were asked the question, namely, did (the witness) exercise his own independent judgment in casting his vote, and each replied in the affirmative. [R. 177, 249, 275, 297.]

[3]Sperling's connection with the venture was withheld from the stockholders: In two paragraphs captioned "Transactions Between the Corporation and Directors", the 1946 Proxy Statement revealed to stockholders that Warner and United were engaged in a motion picture venture; that *Bernhard*, a former Warner director, was financially interested in United. The Statement made no mention of Sperling. [R. 600-601.]

Three of the six aforenamed Warner directors collaborated in drafting this statement: Friedman, Perkins and Carlisle. [R. 482, 485.] Friedman testified the two paragraphs "were intended to satisfy S.E.C. regulations and in addition to that, *put stockholders on inquiry* with respect to a transaction had between the corporation and a relative of its chief executive—" [Emphasis added; R. 484.]

Queried as to whether the directors thought Sperling's financial interest in the venture and his being the president's son-in-law "had better not be mentioned", Mr. Friedman replied that after giving the matter consideration, it was the concensus of opinion "that it need not be mentioned." [R. 485.]

1950; its scope was broadened—three more pictures were added—and Warner became obligated to provide thenceforth, not 50%, but the whole—100 per cent—of the venture's capital requirements.[4]

On July 21, 1950—some five months before the venture was again about to end, with five pictures remaining unproduced—Harry and Jack Warner, acting for Warner, and Sperling for United, negotiated another amendment to the Warner-United contract. [R. 169.] This time, the life of the venture was extended to January 1, 1953; three additional pictures were to be produced; Warner was obligated to furnish 100% of the capital.

Again on August 12, 1952, as the venture was once again about to come to an end, a further amendment—negotiated between Harry Warner, Jack Warner and Sperling—set its expiration date ahead to January 1, 1956; added two more pictures to be produced with 100% Warner capital, and brought up to a total of fifteen, the number of pictures embraced in the venture. [R. 169, 606.]

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[4]By this time, Sperling and his two infant children owned all of United: Bernhard was out. Sperling had bought Bernhard's 125-share stock interest in United and had placed 62 shares in two trusts for the benefit of his two children—Harry Warner's grandchildren. [R. 135-136.] And at this time, Harry Warner had a *personal financial* interest in United: The New York Trust Company loaned United $150,000 on a demand note secured by Harry Warner's personal endorsement. [R. 381-382, 496-497.] The note was unpaid. [R. 382.]

Eight pictures have been produced. A ninth is in the making [R. 154-155] and six are slated to follow, all in a course of dealing between the two corporations that complainant stockholder contends is unlawful, wasteful, unfair to Warner and which is causing Sperling's unjust enrichment at Warner's expense[5], and the corporation contends is lawful, fair, advantageous and furthermore, that the Statutes of Limitations of three states bar the right to the relief prayed for.

After the foregoing realities had been made evident, the inquiry came to a close when the counsel for Warner corporation *admitted* that stockholder and corporation are at odds and occupy opposing positions in the controversy over the legality of the Warner-United relationship; admitted that the Warner directors are inimical and opposed to the suit; ". . . . the defendants' position is that this was an advantageous arrangement to the Warner

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[5]*e.g.* In addition to profits paid to United, pursuant to Subdivision j of the Warner-United Contract [R. 626] which entitles United to receive profits derived from a successful picture, despite losses suffered by the venture in *subsequent* unsuccessful pictures, *Sperling* admits to having received (up to April 2, 1953, the date of answers to requests for admissions), in excess of half a million dollars as salaries and expenses [R. 170] in his twin capacities of "producer" of pictures and "executive" of United. [R. 620.]

This money was charged into the production costs of pictures made and was paid Sperling pursuant to the provisions of subparagraph 4½ of Paragraph 7 of the Warner-United contract. [R. 620.] This paragraph provides in substance, that United's "overhead", unlimited in terms of dollars, is chargeable into the production cost of the pictures and that Sperling's "executive" salary, also unlimited in terms of dollars, be considered a part of such overhead.

corporation and the directors would have upheld it at any time against any attack by any person, including any group of stockholders" and admitted that a demand on the directors, by complainant or by any group of stockholders, that the corporation bring suit against the co-defendants, would have been unavailing. [R. 587-588.]

In short, the inquiry closed [R. 586-587] on the concession by counsel for the Warner corporation that the company was not on the complainant's, but on the defendants' side of the matter in controversy. It sided with them, said the counsel, not because the Warner directorate is dominated and controlled by the co-defendants, "but for the reason that in the opinion of the responsible officers and directors of the corporation this was a good contract." [R. 587-588.]

On behalf of all of the defendants, he moved [R. 588-589] to dismiss the suit on the following grounds:

(a) Failure of jurisdiction because diversity of citizenship is lacking.

(b) The bar of the Statutes of Limitations.

Considerable evidence had been presented by both sides on the Limitations issue. This issue like that of the merits was also not reached, for the Judge (Honorable William C. Mathes) concluded:

(1) To change Warner's position in the suit from the defendant to complainant, align it as such and thereupon dismiss the First Cause of Action (in which United is a defendant) for failure of jurisdiction. [R. 79.]

(2) To dismiss the Second Cause of Action (in which United *is not* named a defendant for the reason that the controversy could not be determined without the presence

of United as a party[6] and consequently that cause was "without equity". [R. 79.]

In an opinion reported in 118 Fed. Supp. 781, Judge Mathes ruled:

(a) In a derivative suit brought in a Federal Court, the stockholders' corporation is alignable as a defendant if shown by preponderating proof to be actually dominated and controlled by the co-defendants; otherwise the corporation is to be aligned as a complainant.

(b) In the preliminary inquiry which the Court had ordered for the purpose of determining at the threshold, the presence of absence of jurisdiction, "neither the Warner corporation nor its Directors or Officers were shown to be at any time under the domination or control of the three brothers Warner" (*Id.* at p. 805); the brothers Warner were shown to have owned "less than 20%" of Warner stock; Warner directors to have exercised "their independent judgment", in good faith, when they considered and approved the Warner-United arrangement. (*Id.* at p. 804.)

(c) Therefore, Warner corporation must be realigned as a complainant with the consequence that diversity is destroyed and the Court rendered without power to proceed to hear the merits of the suit. (*Id.* at 805.)

The Court of Appeals "Affirmed as to the First Cause of Action. Reversed and remanded as to the Second." [R. 673.]

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[6] "No extended discussion is necessary to point out why a decree by this Court as to the Second Cause of Action without the presence of United before the Court would leave the controversy in such a condition that its final determination may be wholly inconsistent with equity and good conscience." (Opinion of the District Court, 118 Fed. Supp. at p. 810.)

## ARGUMENT.

### I.

### There Is Neither Precedent nor Is There Valid Reason for Ruling That a Stockholder's Corporation Is Properly Aligned as a Defendant in a Derivative Suit, Only When Shown to Be "Dominated and Controlled" by the Co-defendants.

Stockholders' corporations in derivative suits have been traditionally aligned as defendants. And this Court has declined, repeatedly, to sanction their alignment otherwise than as defendants, inasmuch as corporate managements are (as Warner's is, in the case at bar) hostile to the objects of the suits; they oppose their being brought; they refuse to institute them; they are (as the Warner directorate admits it is) on the defendants' side of the matter in controversy—they uphold and defend as good and right, conduct which stockholder complainants charge is evil and wrong.

Time and again the Court has been urged to view stockholders' corporations as complainants: In *New Jersey v. Mills* (1884), 113 U. S. 249; in *Railroad v. Grayson* (1886), 119 U. S. 240; in *Doctor v. Harrington* (1905), 196 U. S. 579; in *Venner v. Great Northern Railroad* (1908), 209 U. S. 24. Contention in all these cases that this was the right of the matter centered in the argument that inasmuch as a victory for the stockholder in a derivative suit spells a victory for the corporation, the ultimate interests of the corporation are not in collision, but are rather equatable with those of the stockholder; *ergo* the corporation, like the stockholder, is a complainant and not a defendant.

The contention was rejected in each instance. In *New Jersey v. Mills, supra,* the Court declared the corporation

to be "rightly and necessarily a defendant" (113 U. S. at p. 256) and for the simple, logical and compelling reason that the corporation did not stand for what the complainant stood. It was obviously antagonistic and avowedly on the defendant's side of the matter in dispute. It united with the defendants (as did Warner in the case at Bar) "in defending the acts complained of and in denying the illegality and fraud charged against them." (*Id.* at p. 256.)

In *Railroad v. Grayson, supra,* the Court reiterated its position in the *Mills* case and observed that the suing stockholder "does not represent the company in its corporate capacity and has no authority to do so." (119 U. S. 240 at 244.) In bringing the suit, the stockholder is not suing for his corporation "but for himself." (*Id.* at 244.) This is so, notwithstanding the fact that a decree in his favor results in advantage to the company. "As a stockholder he is seeking protection from the illegal acts of his own company" (*id.* at 244) as well as the illegal conduct of others. And the Court again declined to view the corporation as a complainant and ruled that it was "rightly and necessarily a defendant." (*Id* at 243.)

There is not a word in the opinions of the *Mills* and *Grayson* cases, *supra,* to suggest that the managements of the corporations which were held to be properly aligned as defendants in those cases were under the "domination and control" of the co-defendants.[7]

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[7]"For 51 years since Doctor v. Harrington, supra, I have found no derivative stockholders' action in which the corporation was realigned as a plaintiff, as was done in Smith v. Sperling, supra, especially since there have been many stockholders' class actions where the complaints have even failed to allege antagonistic control and the corporation remains a defendant." Chief Judge Leahy in Gratz v. Murchison, 130 Fed. Supp. 709, 713-714 (D. Del. 1955).

And with deference to the courts below, we submit that neither in *Doctor v. Harrington,* 196 U. S. 579, nor in any other case has this court held "domination and control" of the corporation's directorate to be a prerequisite to maintaining a derivative suit in a Federal Court and naming the corporation as a defendant.

To the contrary, in *Delaware & Hudson v. Albany & Susquehanna,* 213 U. S. 435, 451, the Court indicated that there was no occasion to inquire into the good faith of the directors, for—"they might notwithstanding be firm in their views—firm to resist appeals against them. ". . . The attitude of the directors," Justice McKenna observed, "need not be sinister. It may be sincere. It was so in *Chicago v. Mills,* 204 U. S. 321, and *Ex parte Young,* 209 U. S. 123, and other cases. In this case it was certainly determined."

And see *Ashwander v. Tennessee Valley Authority* (1935), 297 U. S. 288, 319 in which the Court held that it is not incumbent upon a stockholder in a derivative suit ". . . to show that the managing board or trustees have acted *with fraudulent intent or under legal duress.*" Chief Justice Hughes went on to say,

> "The fact that the directors in the exercise of their judgment, either because they were disinclined to take a burdensome litigation *or for other reasons which they regarded as substantial* resolved to comply with legislative or administrative demands, has not been deemed an adequate ground for denying to the stockholders an opportunity to contest the validity of the governmental requirements to which the directors were submitting." (Emphasis added.)

Nor has this Court ever suggested that only when a stockholder's corporation in a derivative suit is alleged

and then proven to be "dominated and controlled" by the co-defendants, is it properly aligned as a defendant while one which is not alleged to be or if alleged to be, is not later proven to be so "dominated and controlled", is properly aligned as a complainant.

These concepts—they underlie the rulings of the Courts below[8]—are not only new to the whole body of judicial thinking on the subject, but they are decidedly at war with familiar doctrines governing alignment which this Court has voiced for some seventy years, for the guidance of bench and bar.

In case after case, this Court has pointed out that where the power to hear and determine the merits depends upon whether the matter in controversy is between citizens of different states, the Court will ascertain the real matter in dispute; (*Pacific R. R. v. Ketchum,* 101 U. S. 289-290) ascertain on which side each party is, really and genuinely; arrange the parties accordingly, (*Helm v. Zarecor,* 220 U. S. at 36) and then see whether all those that are on one side of the matter in dispute are citizens of states different from all those on the other side.

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[8]"It is hardly conceivable that the Court in the *Harrington* case (*Doctor v. Harrington, supra*) enjoined the trial court, on remand after the reversal therein, to entertain the action, even though it should be discovered as a matter of fact that, contrary to allegation, the corporation was not under disabling domination." Opinion of the Court of Appeals. [R. 670.] * * * "A great many of these cases have been decided upon the allegations of the pleadings. If the appropriate allegations are made in the complaint to show the corporation under domination of the individual defendants and the corporation depends upon the same grounds and with the same lawyers as the individual defendants, it is apparent that a prima facie case is made. But, when the trial is over, the court might well find that the corporation was never dominated, but was at all times a free and uncontrolled agency. When such facts are established uncontrovertibly, jurisdiction is at an end and the parties must be realigned." Opinion of the Court of Appeals. [R. 671.]

(*Indianapolis v. Chase Bank*, 314 U. S. 62, 69.) If they are, then the Court has the power to proceed to a hearing and determination on the merits. If not, the power is absent and the case must be dismissed.

In *Doctor v. Harrington*, 196 U. S. 579, the Court reversed the lower court which had apparently viewed favorably the contention that since the "ultimate interest of the corporation made defendant (was) the same as that of the stockholder made plaintiff". (*id.* at p. 587), it was right to realign the corporation as a plaintiff; thereby situate New York citizens on both sides of the litigation; and then dismiss the suit for failure of jurisdiction.

The court's grounds for reversing and restoring diversity and consequently jurisdiction were none other than (1) a stockholder who seeks protection from claimed unlawful conduct of his corporation and others, has a right to sue his company and to name it as a defendant[9] and (2) when such a suit is between citizens of different states, it may be brought in a Federal court. (*Id.* at p. 587.)

The court pointed out that it had always recognized such a stockholder's right to sue his company (*id.* at p. 588); that one of its Equity Rules, namely Rule 94,[10] contemplates and provides for a derivative suit which ex-

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[9]"A corporation is constituted, it is true, of all its stockholders but it has a legal existence separate from them—rights and obligations separate from them; and may have obligations to them. It can sue and be sued." (196 U. S. at 586.)

[10]"Every bill brought by one or more stockholders in a corporation, *against the corporation* and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since, by operation of law;

hibits stockholder and corporation on opposite sides of a controversy.

The court went on to observe (*id.* at p. 588) that the bill showed diversity of citizenship of the parties to be genuine—not simulated or fashioned collusively for the purpose of creating a case cognizable in a Federal court. It showed also, as required by the Rule, the efforts made by the stockholders to obtain redress from the company's "managing directors or trustees" and why these efforts failed: because the directorate was "under the absolute control and domination of the defendant, John J. Harrington and that said Harrington, by reason of having possession of a majority of the capital stock of said corporation" likewise controlled "the action of the stockholders"; and that Harrington had declined to redress the wrongs of which complaint was made. (196 U. S. at p. 588.)

In other words, these allegations of "domination and control" were not a jurisdictional *sine qua non;* their function was (as the Court pointed out in *Venner v. Gt. Northern, infra*, and *Delaware & H. v. Albany & Susquehanna, infra*) to exhibit to a Federal Court *which had jurisdiction* that the plaintiff had either complied with the requirements set forth in the Equity Rule 94 or had exhibited circumstances which excused such compliance.

In *Venner v. Gt. Northern* (1907), 209 U. S. 24, this Court again declined to regard the stockholder's corporation otherwise than as a defendant.

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and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the causes of his failure to obtain such action." (Emphasis added.)

In that case it was argued (seemingly as it was in the *Harrington* case) that the Circuit Court "was without jurisdiction and should have remanded it to the State Court for two reasons. First, because upon a proper alignment of the parties there was not a controversy between citizens of different states. Second, because the cause of action as disclosed by the pleadings showed that the Circuit Court had no jurisdiction over the subject matter" (209 U. S. at 31), *i. e.*, because the plaintiff had failed to comply with Equity Rule 94 in that "Whether or not he was a stockholder at the time when the alleged wrongful acts were committed by the defendants does not appear by any allegations in the complaint (*id.* at 29).

"These reasons," said Mr. Justice Moody, "are entirely independent of each other and require separate consideration. First was there a controversy between citizens of different states?" (*id.* at 31). Justice Moody went on to point out that while the Court may realign parties and place them "on the side where their interests in and attitude to the controversy really places them and then may determine the jurisdictional question in view of this alignment" (*id.* at 31-32) the fact that "it would doubtless be for the financial interests of the defendant railroad that the plaintiff should prevail" . . . . "is not enough" to warrant its being regarded other than as a defendant where (as in the case at Bar) the corporation admittedly "unites with the other defendants in resisting the plaintiff's claim of illegality and fraud"; where (as in the case at Bar) the defendants "are alleged to have engaged in the same illegal conduct and the injury is alleged to have been accomplished by their joint action." Under the circumstances, declared the Court, "the plaintiff's controversy is with both, and both are rightfully and necessarily made defendants and neither can, for jurisdictional

purposes, be regarded otherwise than as a defendant" (*id.* at p. 32, citing . . . *The Central Railroad Co. v. Mills*, 113 U. S. 249; *Railroad v. Grayson*, 119 U. S. 240; *Doctor v. Harrington*, 196 U. S. 579; *Groel v. Electric Co.*, 132 Fed. Rep. 252; *Chicago v. Mills*, 204 U. S. 321).

Coming to the second inquiry, namely, "Did the Circuit have jurisdiction of the subject matter of the litigation?", Mr. Justice Moody rejected the appellant's argument (*id.* at 33) "that a compliance with that rule [Rule 94] is essential to the jurisdiction" and said (*id.* at 34) "Neither the rule nor the decision from which it is derived* deals with the question of jurisdiction of the Courts, but only prescribes the manner in which jurisdiction shall be exercised." The learned Justice went on to point out "The objection that plaintiff has failed to comply with Equity Rule 94 may be raised by demurrer, but the admitted power to decide this question is also an admission that the Court has jurisdiction of the case." (*id.*, at 35.)

In *Delaware & Hudson v. Albany & Susquehanna* (1908), 213 U. S. 435, this Court had occasion to refer specifically to the allegations in the *Harrington* case with respect to "domination and control" and said of these allegations, that though their purpose was to show compliance with the requirement of Rule 94, their effect was "to show a case not of compliance with Rule 94, but circumstances which excused from such compliance." (213 U. S. at 449.)

Rule 94 is now incorporated in R. 23(b), F. R. C. P. In its present form the rule is declaratory of this Court's

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*Hawes v. Oakland*, 104 U. S. 450.

decisions in both *Hawes v. Oakland*, 104 U. S. 450, and *Delaware & Hudson v. Albany & Susquehanna, supra*, in that a plaintiff is now required to show either that he tried to get his corporation to remedy the wrong complained of or that such effort would be vain and futile. As pointed out in the Statement, *ante*, pp. 11-12, defendant's counsel in the case at bar stipulated that such efforts on the part of petitioner would have been futile. [R. 587.]

We submit that a fair evaluation of this Court's reflections in these cases warrants the conclusion that the Court has never held and that there is no valid reason for holding "domination and control" to be a prerequisite to aligning as a defendant a corporation whose directorate is opposed to the suit being brought; refuses to institute it; unites with the codefendants in resisting the stockholder's claim or otherwise manifests that it is on the defendants' side of the matter in controversy.

## II.

## The Warner Directorate Is, Avowedly, on the Defendants' Side of the Matter in Controversy. It Was Error to Realign the Corporation as a Complainant.

Only at the expense of "judicial integrity" (*Indianapolis v. Chase National Bank*, 314 U. S. 62 at 74,) may Warner be allied with the complainant, in face of directors' admissions (Statement, *ante*, pp. 6-7) which attest—to say the least[11]—that they are not on complainant's

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[11]Though found to be not "dominated and controlled" by the Warner brothers the Warner Board stands revealed, nevertheless, as a *sterilized* Board: for inherent in the directors' admissions are factors which tend, inexorably, to erode and destroy the stuff that directorial freedom is made of—the conciousness of being untrammelled, uninhibited in functioning for *all* the stockholders.

side of the dispute; in face of Warner counsel's concession [*ante*, p. 12, R. 587-588] that they are antagonistic to the suit; that the corporation is at one with the defendants in a common contention, viz.: the challenged dealings in which it and they participate, are lawful; and the Warner-United relationship which the stockholder prays the Court to terminate, should not be disturbed.

We contend it was error to align Warner as a complainant when the uncontroverted and admitted facts are—notwithstanding they are omitted from the District Court's findings—that the Warner directorate is on the defendants' side of the matter in controversy; and that it is not only "rooting," so to speak, for complainant's defeat but is definitely striving to bring it about. (*Indianapolis v. Chase Nat'l Bank, supra; Helm v. Zarecoor*, 220 U. S. 32, 36 (1911); *Pacific R. R. v. Ketchum*, 101 U. S. 289, 298 (1879); *Doctor v. Harrington*, 196 U. S. 579 (1904); *Venner v. Gt. Northern Ry.*, 209 U. S. 24, 32 (1907).)

The failure to make these important and, we submit, controlling facts the subject of findings derives, obviously, from the view held below that only "domination and control" by the co-defendants, proven "by a preponderance of the evidence"[12] warrants the alignment of the corporation as a defendant.

The error of both Courts below in realigning Warner Corporation as a complainant thus destroying diversity becomes clear when this Court's language in *Indianapolis v. Chase Nat'l Bank*, 341 U. S. (1941) 63, is adapted to the realities of the present case and it is seen that the question which "permeates this litigation" (*id.*, at 72)

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[12]Opinion of the District Court, 117 Fed. Supp. at 788.

is, should the Court terminate and cancel the Warner-United arrangement as unlawful and unfair to Warner and compel the co-defendants to account for injury they are alleged to have caused.

This is the "primary and controlling matter in dispute" (*id.*, at 72) with respect to which the complainant stockholder is admittedly on one side, and the Warner Corporation and the co-defendants are, by their own admission, indissolubly united on the other side. "Plainly, therefore," (*id.*, at 74) the Warner Corporation and the co-defendants "are, colloquially speaking, partners in litigation." What the complainant wants, the Warner Corporation and the co-defendants do not want. Yet by the decision of the Court below the complainant and the Warner Corporation were ranged alongside one another and "made to have a common interest" and objective when, in reality, they are opposed to each other and are poles apart in what they seek. "Therefore, if regard be had to jurisdictional integrity" the Warner Corporation and the co-defendants "are on the same side of the controversy not only for their own purposes but for purposes of diversity jurisdiction." (*id.*, at 74.)

## Conclusion.

For the foregoing reasons, it is respectfully submitted that that portion of the judgment of the Court of Appeals which affirmed the judgment of the District Court should be reversed, and the case remanded to the Court of Appeals with directions to reverse the judgment of the District Court which dismissed the first cause of action for failure of jurisdiction and to remand the cause to the District Court with directions to try the merits of the controversy.

Respectfully submitted,

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